

ILLINOIS-AMERICAN WATER COMPANY

DIRECT TESTIMONY

OF

JOSEPH F. HARTNETT

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WITNESS IDENTIFICATION AND BACKGROUND

Q. State your name and business address.

A. Joseph F. Hartnett, Jr., American Water Works Company, Inc., 1025 Laurel Oak Road,
Voorhees, NJ 08043.

Q. By whom are you employed and in what capacity?

A. I am employed by American Water Works Service Company (Service Company) as the
Vice President Finance, and I also serve as the Treasurer of American Water Works
Company, Inc. (AWW).

Q. Please describe your educational background and business experience.

A. I graduated from Georgetown University with a Bachelor of Science degree in Business
Administration in 1973. I began my business career with Coopers & Lybrand (currently
PriceWaterhouseCoopers) spending seven years in public accounting as a Certified Public
Accountant (CPA). I then held several positions over eleven years in the securities
industry with Butcher & Company and its principal subsidiary, Butcher & Singer. In
1992 I joined the Service Company as Vice President and Treasurer and was promoted to
Vice President Finance in 1997. Also in 1997 I was named Treasurer of AWW. I am a
member of the American and Pennsylvania Institutes of Certified Public Accountants.

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the process that led to AWW's decision to purchase all of the water and wastewater utility assets of Citizens Utilities Company, now known as Citizens Communications Company (Citizens), and to describe the arm's length nature of the negotiations and reasonableness of the purchase price. I will also discuss steps taken by AWW to facilitate the attraction of capital on reasonable terms.

Q. What was your involvement in the acquisition of the water and wastewater assets of Citizens?

A. I was involved in all aspects of the investigation and analysis that led to AWW's decision to purchase the subject assets of Citizens. This included initial contact with Citizens' executives, assembly and analysis of public information concerning Citizens' water and wastewater properties (including reports to various state public utility commissions and SEC filings), conduct of due diligence investigations, development of the financial analyses utilized by AWW in reaching its decision to purchase Citizens' water and wastewater utility assets, and negotiations with Citizens with regard to a purchase price and other terms and conditions.

Q. Would you generally describe the process that led to AWW's decision to purchase Citizens' water and wastewater utility assets?

A. In approximately mid-May 1999, AWW noted that Citizens had disclosed in their 10-Q filing with the SEC that they planned to sell their public service businesses, including their water and wastewater utility assets. In early June, we participated in a public teleconference call between Citizens and certain financial analysts during which Citizens discussed their recent acquisition of telecommunications properties from GTE and further discussed their intention to sell their water and wastewater properties.

1 During mid-June 1999, we met with Citizens' executives and expressed our
2 interest in the water and wastewater properties. We were informed at that time that if we
3 wished to submit an offer we should feel free to do so.

4 During the months of June and July we accumulated public information on
5 Citizens' water and wastewater properties, including reports to various state public
6 utilities commissions, SEC filings and other documents to determine preliminary
7 valuation of Citizens' water and wastewater properties. On July 22, 1999, we submitted a
8 non-binding expression of interest to Citizens to acquire all of their water and wastewater
9 assets.

10 On August 3, 1999, Citizens appointed Morgan Stanley Dean Witter as its advisor
11 in the divestiture of their public service businesses, including the water and wastewater
12 assets.

13 Also in August, we executed Confidentiality Agreements with Citizens and
14 requested and obtained certain documents from Citizens needed to conduct our due
15 diligence. Due diligence investigations were conducted throughout August and
16 September of 1999 and involved a review of numerous corporate records and other
17 aspects of Citizens water and wastewater business. On September 10, we began price
18 negotiations with Citizens through their Morgan Stanley Dean Witter representative.

19 Intensive negotiations were conducted between AWW and Citizens from
20 September 10 until September 24 when Citizens released an Offering Document to other
21 potential bidders for the water assets. Further intensive negotiations were conducted from
22 September 24 to October 4, when AWW reached agreement with Citizens on a price for
23 the water and wastewater assets and negotiations then began for a definitive agreement for
24 purchase, which was concluded in mid-October, 1999. As discussed by Mr. Gloriod, the
25 bargained price for the assets which Illinois-American Water Company will purchase
26 from Citizens Utilities Company of Illinois and Citizens Business Services Company is
27 \$219,896,000. The negotiations were at arm's length. Both parties relied upon their own
28

1 financial and legal advisors. There were no pre-existing business relationships between
2 Citizens and AWW.

3
4 **Q. How will the acquisition be accounted for?**

5 A. It will be accounted for under the purchase method of accounting in accordance with
6 Generally Accepted Accounting Principles.

7
8 **Q. In your opinion, is the purchase price for the water and wastewater related assets
9 purchased by Illinois-American reasonable?**

10 A. Yes. As discussed by Mr. Bobba, the purchase price for the Illinois water and wastewater
11 assets is within the asset valuations of recent market transactions. This analysis, together
12 with the factors discussed by Messrs. Kelleher and Gloriod, demonstrate that the purchase
13 price is reasonable and that the Illinois acquisition is in the best interests of customers.

14
15 **Q. On Exhibit 6.2, Mr. Bobba presents data showing that, for recent water industry
16 transactions, the acquisition price for common equity was in excess of book value.
17 Would you comment on this data?**

18 A. Yes. These results are not surprising. In today's economy, the values of companies in
19 nearly every industry are above book value. As examples, the market-to-book value ratios
20 reported by Barron's for various stock groupings are shown below. Data for both October,
21 1999, near the time of pricing negotiations between AWW and Citizens, and June, 2000
22 are shown.

Market to Book Ratios

	October, 1999	June, 2000
S & P Industrial Index	8.52	9.44
S & P 500 Index	6.37	6.99
Dow-Jones Industrials	6.39	6.18
Dow-Jones Utilities	2.53	2.66
Dow-Jones Transportations	2.11	1.88

Q. Will Illinois-American be required to issue debt to consummate the proposed transaction.

A. Yes, as discussed in Mr. Ruckman's testimony, Illinois-American anticipates issuance of short term debt in an amount not exceeding \$137.5 million in connection with this transaction. This debt will then be converted into long- term debt within one year following closing of the transaction.

Q. Has AWW taken steps to secure financing for Illinois-American ?

A. Yes. AWW recently formed American Water Capital Corp. ("AWCC") which will provide debt capital for Illinois-American and other subsidiaries of AWW at a cost rate at or below that which could be obtained by the subsidiary on an independent basis. Illinois-American's request for approval of an affiliated interest agreement with AWCC was approved by the Commission in Docket 00-0306.

Q. Does that conclude your prepared testimony?

A. Yes, it does.